

TEACHERS' RETIREMENT BOARD  
SUBCOMMITTEE ON CORPORATE GOVERNANCE

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SUBJECT: Securities Litigation Policy

ITEM NUMBER: 4

ATTACHMENT(S): 4

ACTION: X

DATE OF MEETING: January 5, 2000

INFORMATION: \_\_\_\_\_

PRESENTER(S): Mr. Waddell

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Attached for the Subcommittee's consideration is a draft policy for CalSTRS' involvement in securities litigation matters (Attachment 1). If approved, it will be substituted for existing Section B (4) (d) of the Corporate Governance Policy (Attachment 2). Also included for the Subcommittee's reference is the shareholder litigation item that was presented to on September 1, 1999 (Attachment 3).

While much of the attached policy is self-explanatory, several items require elaboration, as follows.

***Goal and Objectives of Policy:*** Staff believed that it was important to set forth at the outset the purpose for the System's involvement in this area. The identified goal is to enhance the long-term value of the CalSTRS portfolio, consistent with the Investment Management Plan of the System. The objectives that contribute towards meeting that goal consist of: 1) increasing the dollar value of a settlement in a given case over what might be obtained absent CalSTRS' involvement; 2) increasing the long-term value of an ongoing CalSTRS' asset, most likely through corporate governance reforms obtained as a result of a class action settlement; 3 and deterring wrongful corporate conduct. Staff believes that if active CalSTRS involvement in a particular case does not provide the opportunity to fulfill at least one of these objectives, such involvement should not be undertaken in that case.

***Criteria for Seeking Lead Plaintiff Status:*** The proposed policy identifies a threshold potential damages amount of \$5 million for seeking lead plaintiff status except for those cases where there are strong alternative grounds, including cases where there is an exceptional opportunity to preserve or enhance the long-term value of a significant portfolio holding or to deter wrongful corporate conduct. The \$5 million amount, calculated by looking at purchases of target company shares during the class period net of sales during the same period, represents an attempt to identify that amount where active CalSTRS involvement could make a material financial difference to its portfolio. The Subcommittee will recall from the earlier presentation on this subject that the average settlement in a securities class action case recovers approximately 10-14% of total damages. As such, in a hypothetical case where CalSTRS' total damages are \$5 million, the average recovery if CalSTRS were to remain a passive class participant would be \$500,000 to \$540,000. If, through CalSTRS' active participation, the settlement recovery was

improved to 25% of total damages or \$1.25 million, the net increase to CalSTRS would be \$710,000 to \$750,000.

Based on the above, staff believes that \$5 million represents the appropriate threshold that should be considered for seeking lead plaintiff status based solely on the objective of maximizing the economic return of that case. However, staff has included alternative criteria based upon corporate governance/deterrence considerations in order to provide the System with the flexibility to consider involvement in appropriate cases that do not satisfy the dollar threshold.

***Evaluation of Cases for Potential Lead Plaintiff Status:*** If staff determines on a preliminary basis that seeking lead plaintiff status should be proposed to the Subcommittee/Committee, under the draft policy the case would be referred to outside counsel for evaluation. It is contemplated that this evaluation would include an analysis of the strengths and weaknesses of the case, the recoverable damages, and the advantages and disadvantages to CalSTRS of becoming lead plaintiff in the particular case. Such counsel would be identified in advance through a competitive process and compensated on an hourly or flat fee basis. To ensure their objectivity, such counsel would not be eligible to serve as class counsel in that case if CalSTRS is selected as lead plaintiff; but for reasons noted below such counsel would file and argue the initial motion for CalSTRS to be named lead plaintiff.

***Selection of Lead Counsel:*** As was observed in the September presentation on this subject, the selection of lead plaintiff in securities class action litigation has often been a very contentious process, and at times has led to bitter disputes between institutional investors. Staff believes that much of the “heat” in these disputes can be traced to the underlying issue of selection of lead counsel. Typically, individuals and institutions seeking lead plaintiff status have pre-selected the counsel that would serve as lead counsel if they were selected as lead plaintiff. This creates an incentive for counsel for each moving party to attack the other parties, since loss of the lead plaintiff motion likely also means the loss of the opportunity to serve as lead counsel.

Staff believes that CalSTRS should pursue a different approach. Under the proposed policy, evaluation counsel would also file and argue the motion for designation as lead plaintiff. However, instead of going on to serve as lead class counsel if CalSTRS were named as lead plaintiff, the firm would be ineligible to serve in this capacity in that case. Instead, immediately after designation by the Court as lead plaintiff, CalSTRS would complete an expedited competitive process for the selection of lead class counsel. Although it would involve some up-front expenditure by CalSTRS, staff sees the following advantages in this approach. First, it avoids locking the System into a counsel and fee relationship early in the process when it may be difficult to determine whom the most appropriate lead class counsel is and what the most appropriate fee agreement may be. Second, it eliminates the incentive for counsel for other movants for lead plaintiff status to attack CalSTRS during that process, since all such counsel would be potential contestants for lead counsel if CalSTRS was selected by the Court as lead plaintiff. Third, staff believes that a competitive process conducted by CalSTRS *after* being

selected as lead plaintiff will yield the most cost-effective fee arrangements and enhance the likelihood of Court approval of lead counsel.

***Alternatives to Seeking Lead Plaintiff Status:*** The proposed policy identifies both litigation and non-litigation alternatives to seeking lead plaintiff status in securities class action litigation. These alternatives were previously identified to the Subcommittee during the September presentation.

***Authority to Approve CalSTRS Involvement:*** Under the proposed policy, seeking lead plaintiff status and pursuing other litigation alternatives that would either place CalSTRS in a leadership position with respect to litigation or would involve a significant expenditure of funds or System resources would require the approval of the Subcommittee and the Investment Committee. Conversely, other litigation alternatives such as filing briefs or motions with the Court concerning particular aspects of a case in which CalSTRS is interested or participation in settlement negotiations in a case (where CalSTRS is not a lead plaintiff) would not require Subcommittee or Committee approval, although such activities would be regularly reported upon. Non-litigation alternatives that are supplemental to CalSTRS' participation as a passive class member would not require approval unless such approval was otherwise required under existing Board policy (e.g., pursuit of shareholder proposals or similar corporate governance activities).

***Staff Recommendation:*** Adopt the proposed shareholder litigation policy and incorporate it into the Corporate Governance Policy.

d. Securities Litigation: CalSTRS will manage its interests in securities litigation matters as assets of the trust fund with the goal of enhancing the long-term value of the portfolio consistent with the Investment Management Plan. Consistent with this goal, CalSTRS will pursue the following objectives:

- Increasing the net monetary value of settlements;
- Increasing the long-term value of shares in a company subject to shareholder litigation held in CalSTRS' portfolio;
- Deterring wrongful corporate conduct that undermines the integrity of the financial markets.

In most cases, CalSTRS' interests in securities class action litigation claims will be adequately addressed solely through passive participation as a class member. However, in select cases a higher level of involvement will be appropriate, including:

- ***Moving for Lead Plaintiff Status:*** In securities class action cases where CalSTRS' potential damages exceed \$5 million, or in other cases where there is an exceptional opportunity to preserve or enhance the long-term value of a significant portfolio holding or to deter wrongful corporate conduct, CalSTRS will consider moving for lead plaintiff status. If staff concludes that seeking lead plaintiff status is appropriate, the case will be referred to outside counsel for evaluation and recommendation to the Subcommittee on Corporate Governance/Investment Committee. Such counsel shall be selected and compensated on a retainer basis to evaluate the case, make a recommendation thereto, and to represent CalSTRS in the filing of a motion for lead plaintiff status if such action is approved, but shall not otherwise be eligible to represent CalSTRS as lead class counsel if CalSTRS is selected as lead plaintiff.

A determination on whether to seek lead plaintiff status shall be made by the Subcommittee on Corporate Governance/Investment Committee. If, pursuant to such Subcommittee/Committee approval, lead plaintiff status is sought and approved by the Court, CalSTRS will conduct a competitive selection of lead class counsel in order to secure the most qualified counsel at a fee structure that aligns the interests of the class and lead counsel.

- ***Alternatives to Lead Plaintiff Status Requiring Subcommittee/Committee Approval:*** In some instances where seeking lead plaintiff status is not sought or where the court has denied a motion therefor, CalSTRS may consider the following alternatives: 1) Participating as a co-lead plaintiff with other institutional investors; 2) Opting out of a class and filing a separate securities action in state or federal court; 3) Filing a shareholder derivative claim in state or federal court; 4) Formal or informal intervention in pending litigation and/or filing objections to inadequate class action

settlements. Such actions shall require the approval of the Subcommittee on Corporate Governance/ Investment Committee following an evaluation by staff and outside counsel.

- ***Litigation Alternatives Delegated to Staff:*** If, in a particular case, the seeking of lead plaintiff status or the above alternatives is either not deemed to be appropriate or is not approved by the Court, but staff believes that some active involvement by CalSTRS would be consistent with the goal and objectives of this program, on the recommendation of the Chief Counsel and approval of the Chief Executive Officer CalSTRS may: 1) Attempt to persuade another claimant whose interests are aligned with CalSTRS to seek lead plaintiff status; 2) File briefs or motions with the Court concerning the selection of lead plaintiff, lead counsel, or other litigation matters; 3) File a notice of appearance and more actively monitor the case; or 4) Participate in settlement negotiations or consult on a proposed settlement.
- ***Non-Litigation Alternatives:*** In considering the appropriate response to a company that is subject to shareholder litigation, CalSTRS will evaluate the pursuit of alternatives to litigation that address the underlying cause of the company's problem. For example, contacting appropriate regulatory and/or law enforcement agencies about potential prosecution of wrongdoers may deter similar conduct in the future that undermines the integrity of the financial markets. As another example, filing shareholder resolutions or negotiating for corporate governance changes like the addition of independent directors or the creation of an independent audit committee may address the problems that lead to the litigation and could aid in the long-term recovery of the company and the value of its stock.

## **CalSTRS CORPORATE GOVERNANCE PROGRAM**

### **A. Introduction**

***Philosophy:*** The California State Teachers' Retirement System (CalSTRS) is committed to holding and managing equity investments and to exercising the shareholder rights appurtenant to those investments, all for the benefit of its participants and beneficiaries. It is the fiduciary responsibility of the Teachers' Retirement Board (TRB) to discharge its duty in the exclusive interest of the participants and beneficiaries and for the primary purpose of providing benefits to participants and their beneficiaries. The TRB should defray the reasonable expenses of administering the Fund; the investment policy of the Fund should reflect and reinforce this purpose. The TRB views its corporate governance role as that of a catalyst for enhanced management accountability, disclosure and performance. The objective of the TRB's corporate governance effort is to enhance long-term shareholder returns.

CalSTRS is a long-term investor; its long-term strategy is demonstrated through its significant commitment to passively managed portfolios in its three largest asset categories: Domestic Equities, Fixed Income, and International Equities. CalSTRS' thrust in corporate governance is to maximize the longer-term value of the shares, consistent with its role as a significant capital allocator.

***Statutory Authority:*** Education Code Section 22354 requires the Board to retain investment managers who are experienced and knowledgeable in corporate management issues to monitor corporations whose shares are owned by the System plan and to advise the board on the voting of the shares owned by the plan and on all other matters pertaining to corporate governance.

While CalSTRS is not subject to the Employee Retirement Income Security Act (ERISA), applicable provisions of both the California Constitution and the Education Code make clear that CalSTRS' commitment to corporate governance is a diligent exercise of its fiduciary responsibility. As observed by the U.S. Department of Labor:

“In general, the fiduciary act of managing plan assets which are shares of corporate stock would include the voting of proxies appurtenant to those shares of stock. ... Moreover, because voting such proxies involves plan asset management, section 403(a) requires that plan trustees have the exclusive authority and responsibility for voting these proxies...”

Thus, CalSTRS' legal authority for corporate governance springs from its fiduciary concerns as a prudent investor and the statutory obligation imposed on it by the Legislature.

## **B. Corporate Governance Policies**

The following represent the approved policies to be used in the exercise of CalSTRS' shareholder rights and the implementation of its Corporate Governance Program. The policies are designed to set boundaries for the management of proxies and other corporate actions. As with all other plan assets, these corporate governance policies cannot be altered without explicit direction from the TRB.

1. **LAWS AND STATUTES:** The Corporate Governance Program (Program) for the California State Teachers' Retirement System (CalSTRS) will be managed in a prudent manner for the sole benefit of the CalSTRS participants and beneficiaries, in accordance with the Teacher's Retirement Laws and other applicable State statutes.
2. **REGULATIONS:** For domestic equities, the Program will comply with the rules of the Securities and Exchange Commission (SEC), equity exchanges, and other regulatory agencies. For non-U.S. equities, the Program will comply with the appropriate regulatory body in the respective country.
3. **PROGRAM OBJECTIVE:** The Program shall be managed to provide long-term enhanced shareholder value through clear and certain disclosure and accountability. Enhancing shareholder value shall always take precedence, non-financial or collateral benefits notwithstanding.
4. **PROGRAM COMPONENTS:** The Program shall consist of the following components:
  - a. **Voting of Proxies:** CalSTRS will make a best effort to vote all domestic and international proxies; exceptions may be made based on the legal requirements or local conventions of certain markets and where practical difficulties make an informed and meaningful decision impossible. Voting of proxies shall be in conformance with the "Financial Responsibility Criteria for Corporate Investments." (Attachment A)
  - b. **Annual Workplan Companies:** CalSTRS will continue its practice of identifying for enhanced shareholder action, on an annual basis, companies in which the System holds a significant passive investment position that are underperforming applicable performance benchmarks. In the organization and completion of this Workplan, staff shall consider the market value of the investment, CalSTRS' ownership percentage, and the resources required and the direct cost involved in seeking a desired result.

"Enhanced shareholder action" includes, but is not limited to:

- Informal or formal expressions of concern to company management concerning corporate governance practices that are adversely affecting shareholder value;
  - Development of shareholder proposals, either individually or in concert with other institutional investors;
  - Participation by CalSTRS in litigation, consistent with its policy with regards thereto, in the event that the subject company's underperformance is related to matters that are or may become the subject of such litigation.
- c. Corporate Governance Organizations: CalSTRS will continue its active participation in the Council of Institutional Investors and in other forums designed to have an impact on corporate governance practices.
- d. Securities Litigation: In addition to its ongoing practice of monitoring and filing claims as appropriate in securities class action litigation, CalSTRS will develop a policy for active participation in securities class action and shareholder derivative litigation, including but not limited to:
- Criteria for seeking lead plaintiff status in securities class action litigation and/or for the filing of shareholder derivative litigation based upon the financial stake of CalSTRS in the litigation recovery, the opportunity to enhance the value of a long-term holding in the subject company through the inclusion of governance reforms in a class action settlement, and/or the potential deterrent effect of the case on future corporate wrongdoing.
  - Criteria for participation in securities class action litigation and/or shareholder derivative litigation other than as lead counsel, such as monitoring of significant cases, the provision of *amicus curiae* or other assistance to institutional investors in such litigation pursuing interests aligned with CalSTRS, and intervention in such cases where appropriate to protect or advance CalSTRS' interests.
  - Criteria for working cooperatively with regulatory authorities such as the SEC, with securities exchanges and with prosecutorial authorities to bring about more aggressive civil and criminal sanctions against corporate officers and employees engaged in fraudulent behavior that undermines the integrity of the financial markets.
- e. Statement of Investment Responsibility: The "Statement of Investment Responsibility" (Attachment B) remains in effect.
5. **BUSINESS PLAN**: The Program will be managed in accordance with a business plan which will be prepared on an annual basis and will describe CalSTRS' objectives for the next twelve-month period.
6. **MONITORING**: Staff shall monitor adherence to the corporate governance policy for all internal and external managed portfolios.



7. **AUTHORIZED ACCESS:** Authorization memoranda, delineating access and authority levels relating to CalSTRS corporate governance related business, will be provided to the master custodian, staff and proxy voting intermediary. Whenever there is a change in authorized personnel a written notice shall be provided to each affected party, within 48 hours of change.
8. **DELEGATION OF AUTHORITY:** The Chief Investment Officer (CIO) or designee has the authority to manage the Corporate Governance Program and may use other investment personnel to implement these policies.
9. **DECISION-MAKING AUTHORITY:** Subject to the review and approval of the Investment Committee and the TRB, the Subcommittee on Corporate Governance shall:
  - Review and make recommendations with regard to this Policy, the Financial Responsibility Criteria for Corporate Investments (Attachment A), the Statement of Investment Responsibility (Attachment B);
  - Receive reports from staff on the status of current proxy votes, and recommend to the Investment Committee action to be taken on votes which do not fall within the guidelines;
  - Direct development of the Annual Corporate Governance Plan;
  - Receive from staff annual summaries of votes cast on behalf of the Board;
  - Act as liaison between the Board and the Council of Institutional Investors;
  - Monitor developments in the corporate governance area that may affect the value of shares held by the System;
  - Develop and propose various actions related to corporate governance, including, but not limited to, shareholder resolutions, criteria for selection of companies for focus lists, criteria for entering into litigation related to securities fraud and/or to accomplish the purposes of the corporate governance policy.
10. **REPORTING:** Staff shall present quarterly reports to the Sub-Committee on Corporate Governance on all actions taken to implement the corporate governance policy, including corporate actions, litigation, and proxy votes cast.

Approved by the Subcommittee on Corporate Governance: October 13, 1999

Adopted by the Investment Committee: October 13, 1999

TEACHERS' RETIREMENT BOARD  
SUBCOMMITTEE ON CORPORATE GOVERNANCE

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SUBJECT: Panel Discussion – Shareholder Litigation

ITEM NUMBER: 4

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ACTION:       

DATE OF MEETING: September 1, 1999

INFORMATION:   X  

PRESENTER(S): Mr. Waddell

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Securities class action litigation has existed for many years, and CalSTRS has participated in such litigation both as a passive class member and, in one instance, as a co-lead plaintiff (Cal Micro Devices). More recently, much attention has been focused on the role of institutional investors such as CalSTRS in such litigation as a result of the Private Securities Litigation Reform Act of 1995 (PSLRA), which was enacted over President Clinton's veto in late 1995.

Specifically, a number of the stakeholders in this area (the Securities and Exchange Commission (SEC), academics, corporate governance activists, and, more recently, members of the plaintiffs' attorneys' bar that has litigated these cases in the past have urged institutional investors, and public pension funds in particular, to seek so-called "lead plaintiff" status in securities class action litigation. The purpose of today's panel is to provide the Corporate Governance Subcommittee with a range of views of the advantages and disadvantages of this course of action as well as to discuss the mechanics involved and possible alternatives to this approach. The following information is provided to the Subcommittee by way of brief introduction to the subject area.

**A. Nature and Causes of Securities Class Action Litigation**

Securities class action litigation as a term of art essentially refers to litigation involving securities fraud or some other form of corporate malfeasance that is brought as a class action. A "class action" is a case that is brought by an individual, group of individuals or entity on behalf of all others who have suffered the same type of loss. In a class action, everyone is in the "class," i.e., those who suffered harm are covered for all purposes of the litigation by the results of such litigation unless a class member "opts out." A class member that opts out chooses not to participate in the class action and instead elects either to file a separate case in the member's own name or not to engage in any litigation.

Securities class action litigation may be filed in either state or federal court, although this discussion will be limited to such actions that are filed in federal court since that has been the focus of institutional investor involvement. The litigation is brought in the shareholders' names against the offending corporation, and sometimes as well against individual officers thereof and/or other parties that may have played a role in the alleged wrongdoing (such as accounting firms). As such, this type of litigation may be distinguished from shareholder derivative actions, in which shareholders sue individual officers and/or employees of the corporation and/or involved third parties *on behalf of* the corporation. In other words, a securities class action is a lawsuit by shareholders seeking reimbursement *from* the corporation and related parties for their losses, while derivative cases seek reimbursement from individuals or entities *to* the corporation.

Most frequently, securities class action litigation is triggered by the following elements: 1) a major move in the price of a security (usually, but not always downward), and 2) either insider trading by corporate insiders and/or accounting irregularities. Roughly 50 or 60 percent of such cases involve allegations of insider trading and approximately 60% involve allegations of accounting irregularities. Some complaints allege both of the latter elements; only 10% allege neither.

In securities class action litigation, the court appoints a lead plaintiff. The lead plaintiff is, in effect, the representative of the class and has the responsibility to supervise plaintiffs' counsel in the conduct of the litigation. This includes the formulation of litigation strategy and, most significantly, the negotiation of any settlement of the litigation. If a proposed settlement is reached, the agreement is subject to a review by all class members, who may advise the court of any objections to its contents. The court is given the final say with respect to acceptance or rejection of the agreement after considering arguments both pro and con from the class.

## **B. Pre-PSLRA Criticisms of Securities Class Action Litigation**

In the years prior to the enactment of the PSLRA, securities class action litigation came under increasing scrutiny for several reasons. First, identification of a lead plaintiff was largely a function of which plaintiffs' attorney was able to "win the race to the courthouse" and be the first to get a lawsuit on file. Second, the lead plaintiff was generally an individual shareholder "found" by the attorney, who often had a relatively small number of shares in the defendant corporation and therefore may not have been the best representative of the class at large. Third, defendant corporations claimed that many of the cases were "strike suits," i.e., cases with little or no merit filed in an effort to obtain a nuisance value settlement. Fourth, shareholder advocates contended that meritorious cases were being settled for inadequate consideration, either or both in terms of monetary value and nonmonetary remedies (such as corporate governance reforms). Fifth, the percentage of case recoveries going to plaintiffs' attorneys (typically 30%) was criticized as being too high related to both the time expended by counsel and the value received by shareholders.

### **C. Enactment of the PSLRA**

The PSLRA made a number of significant changes in the way in which securities class action cases are handled in federal court. It requires parties that wish to serve as lead plaintiff to file an application with the court, which then must select “the most adequate plaintiff as lead plaintiff.” There is a presumption that the person or group with the largest financial interest in the relief sought by the class is the most adequate plaintiff, unless that person or group is subject to unique defenses or otherwise cannot be expected to fairly and adequately represent the class. It should be noted that the largest financial interest is not determined by the entity with the largest absolute loss in the security, but rather by the largest monetary loss resulting from a drop in securities purchased during the class period in which the wrongdoing took place. For example, assume that XYZ corporation sustained a 50% percent drop in the price of its common stock and two stockholders, A and B, are competing for selection as lead plaintiff. If A owned \$2 million in shares prior to the drop, but purchased only \$250,000 of the shares during the class period, it would have less of a financial interest in the litigation than B, which owned \$1 million of the shares prior to the drop, all of which were purchased during the class period. Although A’s total losses are more than B’s, its financial interest in the litigation is \$125,000, which is less than B’s financial interest of \$500,000.

Although this provision was designed to favor the appointment of institutional investors as lead plaintiffs, the results to date have been far from definitive. Perhaps not surprisingly, the court procedures concerning lead plaintiff appointment have often become very contentious. Where institutional investors have sought lead plaintiff status, they have often found themselves in competition with large aggregations of individual shareholders, combinations of individual and institutional investors, and other stand-alone institutional investors. Often, the lead plaintiff application of an institutional investor is challenged on the grounds that their interests are dissimilar from those of the individual investors. For example, institutional investors are portrayed as “buy and hold” investors with different interests in the outcome of the litigation than “buy and sell” individual investors.

The judicial response to this situation has been mixed. In some instances, institutional investors have been appointed as sole lead plaintiff. In others, an aggregation of individual plaintiffs have been appointed as “co-lead plaintiff” with an institutional investor or a group of institutional investors. Such arrangements pose obvious issues of command and control of the litigation. This is still an evolving area under the PSLRA.

Once a court has selected a lead plaintiff or co-lead plaintiffs, the lead plaintiff(s) may then select class counsel. The selection of class counsel is subject to court approval. As such, counsel representing the lead plaintiff during its application for lead plaintiff status may end up not representing the class in the actual litigation. This is not a merely theoretical result. Some courts have been very active in their review and approval of class counsel, to the point of ordering that firms wishing to serve as class counsel participate in an “auction” process where an otherwise qualified firm that submits the lowest fee bid wins the right to represent the class; sometimes, but not always, with the lead plaintiff’s firm of choice being given the opportunity to match the low bid.

#### **D. Possible Rationales for Public Pension Funds to Seek Lead Plaintiff Status in Securities Class Action Litigation**

As noted previously, there has been an increasing call for institutional investors generally, and public pension funds specifically, to affirmatively seek out lead plaintiff status in securities class action litigation. Those who support this call have contended that active public pension fund participation in this litigation could bring about the following salutary benefits:

- Increased settlement recoveries;
- Reduced attorneys' fees;
- A higher level of accountability for corporate wrongdoing, by either holding corporate officers personally liable and/or by enacting corporate governance reforms designed to prevent a repeat of the problems (appointment of outside directors, independent audit committees, etc.).

In addition, there is a view that increased institutional involvement as lead plaintiffs could discourage the filing of frivolous lawsuits by refocusing contingent fee agreement practices to provide very low fee percentages in so-called "nuisance value" cases and/or by taking control of such suits when demonstrated to be nonmeritorious and seeking an early resolution thereof.

In essence, the suggested role for public pension funds in securities class action litigation represents an effort to put the interests of class members ahead of those of class counsel and to increase the deterrent effect of such litigation. By this means, it is hoped that such actions would provide a higher level of compensatory value to those who actually were harmed by corporate wrongdoing, and that greater integrity in the underlying financial markets generally would result.

In a recent court filing, the Secretary of the U.S. Department of Labor has suggested that ERISA fiduciaries have an affirmative duty to determine whether it would be in the interest of plan participants to seek to serve as a lead plaintiff in securities class action litigation. Finally, there is a view in the public pension fund field that with some public pension funds already getting involved, others need to "take their turn at bat."

With respect to the "case specific" economics, the following statistics are provided for the Subcommittee's information. The most-frequently cited figure for the average settlement in a securities class action case is approximately \$10 million. The range of actual recoveries is very wide, although few cases have settled for in excess of \$100 million. These settlements recover, on average, approximately 10-14% of the total actionable loss sustained by shareholders. These settlements are almost always fully covered by proceeds from the defendant corporations' insurance proceeds. Plaintiffs' attorneys typically receive approximately 30% of the settlement proceeds as their fee, although there appears to be a recent trend of a lowered percentage in the larger cases. There are approximately 500 securities class action cases currently pending in federal court.

CalSTRS, as a passive class member in securities class action litigation, has received a total of \$7,961,742 in proceeds from some 400 cases since January 1986 to the present. The average

proceeds on a per-case basis were \$19,904, and the median amount received was \$5887. The range in proceeds was from a low of \$1.00 to a high of \$877,455. Six-figure amounts have been received in 13 cases to date.

As reflected by the above statistics, the difficulty with CalSTRS pursuing lead plaintiff status for case-specific economic reasons is that in most instances the incremental increase to a class action settlement that may result, while large in absolute dollar terms, will be relatively small in terms of CalSTRS' share thereof. Unlike some public pension funds that have taken a very active role in this area, such as the State of Wisconsin Investment Board (SWIB), which is actively managed and has taken relatively large stakes (10-20%) in the stock of specific companies, CalSTRS is largely indexed and rarely owns more than 1% of the outstanding shares of a publicly traded corporation. As a result, even if CalSTRS was able to become lead plaintiff in a case that would otherwise have settled for \$50 million but, through CalSTRS' proactive management of the litigation settled instead for \$100 million, if CalSTRS had a 1% share of the recoverable losses the net gain to the System over passively participating in the case would only be \$500,000.

As a result, there are likely very few cases where CalSTRS should consider seeking lead plaintiff status purely to maximize its economic recovery in the litigation. Staff believes that the Board's fiduciary obligations in this regard would be fulfilled if, on a case-by-case basis, any cases in which CalSTRS had a significant financial interest (in terms of both purchases during the class period and absolute dollar amount) were brought to the Investment Committee for consideration of seeking lead plaintiff status.

In addition, it should be noted that public pension funds such as CalSTRS could exert significant influence on the outcome of such litigation in some instances in the absence of seeking lead plaintiff status. For example, CalSTRS could advise the court of its support of a public pension fund's application for lead plaintiff status where appropriate. Also, some funds are engaging in active monitoring of litigation involving a significant fund holding, with the prospect of formally intervening in such litigation in the event that its interests are not adequately being represented. Another alternative is actively opposing an inadequate settlement and urging more appropriate terms at the time the matter is before the judge for approval.

The issue of pursuing lead plaintiff status in appropriate cases for the purpose of bringing about greater accountability for corporate wrongdoing is deserving of careful consideration by the Subcommittee. Allegations of insider trading and accounting irregularities and litigation arising from such allegations have existed for years, and if anything have been on the increase recently. Plainly, the manner in which shareholder class action litigation has been conducted over the same period of years has done little to deter such wrongdoing. It is not difficult to understand why this is so, in that with insurance proceeds covering most settlements and with individual corporate wrongdoers rarely facing personal financial liability, there is generally no accountability for wrongdoing in the litigation process.

One option of several for attempting to bring more accountability for corporate wrongdoing would be for public pension funds such as CalSTRS to seek lead plaintiff status and attempt to seek a resolution of the case, by settlement or otherwise, that would include such factors as

personal liability in some amount for those involved in the unlawful activity and/or corporate governance reforms such as the appointment of an independent audit committee and/or outside directors. Such action could serve to both get at the real problems in the corporation that allowed the unlawful activity to take place in the first place as well as to create some measure of deterrent effect more generally in the market. This strategy would be complementary with the System's current corporate governance activities, which are geared to increasing shareholder value both in individual "targeted" corporations as well as in the markets at large.

Pursuit of lead plaintiff status for these reasons could potentially place the public pension fund at odds with other class members that are more interested in simply maximizing their financial recovery from their failed investment. This is likely not an insurmountable problem, however, since these objectives are not necessarily inconsistent with maximizing the financial aspects of a given settlement.

There are some options that have been discussed in this area that could be pursued either in concert with or as an alternative to seeking lead plaintiff status for "governance/deterrence" purposes. These include: 1) Working with the SEC to enhance their civil and criminal enforcement capabilities in this area; 2) Working with appropriate offices of the United States Attorney to seek criminal prosecutions of corporate officers in particularly egregious instances of fraud, such as what occurred in the Cal Micro Devices case; and 3) working with the insurance companies that underwrite corporate errors and omissions policies on "best practices" procedures that could be followed by a corporation in exchange for reduced insurance premiums.

#### **E. Introduction of Panel**

To discuss the issues raised above, and to address any other related matters of concern to Subcommittee members, the following four panelists will make brief presentations and then be available as a group to answer any questions.

**Sarah Teslik** is the Executive Director of the Council for Institutional Investors. Founded in 1985, the Council is an organization of over 100 public, corporate and Taft-Hartley pension funds that seeks to address investment issues affecting the size and security of its members \$1.3 trillion in assets. Prior to the formation of the Council, Ms. Teslik was a corporate and securities attorney with Willkie Farr & Gallagher in Washington, D.C. Ms. Teslik has a B.A. in History from Whitman College, Walla Walla Washington, an M.A. in Modern History from Oxford University, and a J.D. from Georgetown University Law Center in Washington, D.C.

**George Kim Johnson** is the General Counsel for the Public Employees' Retirement Association of Colorado, with assets of \$28 billion. Prior to joining ColPERA, he was General Counsel for the Louisiana State Employees' Retirement System. Kim is past president of the National Association of Public Pension Attorneys, serves on the Executive Committee of the Council for Institutional Investors, is a member of the Board of Governors of the International Corporate Governance Network, and represents ColPERA on the Advisory Board of the Global Corporate Governance Research Center. He received a B.A. in Government and his J.D. from Louisiana State University.

**Jean S. Moore** is a partner with Hogan and Hartson in Washington, D.C. and is a member of the firm's litigation practice, emphasizing corporate financial and securities fraud litigation. She has represented both plaintiffs and defendants in federal and state securities litigation, and along with Joe Hasset and George Mernick is currently lead plaintiffs' counsel for CalSTRS and ColPERA in the California Micro Devices case. Prior to joining Hogan and Hartson, she was with the White House Office of Special Counsel. She received her B.A. and J.D. degrees from Ohio State University.

**Ian Lanoff** is a principal at Groom Law Group in Washington, D.C. and is a member of the firm's employee benefits practice. In addition to serving as CalSTRS' fiduciary counsel, he is outside fiduciary counsel for the Texas Teachers Fund and the Florida Public Employees Pension Fund, and advises corporate pension plan clients sponsored by A T & T, U.S. West, Microsoft, Sears, Delphi, and Agway. He additionally represents a number of multiemployer Taft-Hartley pension plans. Prior to entering private practice, Mr. Lanoff was the Administrator of Pension and Welfare Benefit Programs at the U.S. Department of Labor. He received his B.A. and J.D. degrees from the University of Michigan and his L.L.M. from Georgetown University Law School.



PROPOSED  
RESOLUTION  
OF THE  
TEACHERS' RETIREMENT BOARD  
SUBCOMMITTEE ON CORPORATE GOVERNANCE

Subject: Securities Litigation Policy

Resolution No. \_\_\_\_\_

WHEREAS, the Subcommittee on Corporate Governance is responsible for reviewing and making recommendations with regard to the Corporate Governance Policy for the California State Teachers' Retirement System; and

WHEREAS, the Subcommittee desires to adopt a policy concerning the participation of the System in securities litigation matters; and

WHEREAS, the Subcommittee has reviewed the written material and oral presentation from staff; Therefore, be it

RESOLVED, that the Subcommittee hereby adopts the proposed policy on securities litigation and incorporates it into the Corporate Governance Policy of the System.

Adopted by:

Subcommittee on Corporate Governance  
On January 5, 2000

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James D. Mosman  
Chief Executive Officer